c. The Exogenous Change Factor

In its 1994 Order, the Commission established an exogenous change factor to address cost changes outside the Company's control, subject to certain limitations:

> "Exogenous factor treatment should be allowed only for costs which are truly outside the Company's control. Further, the costs should be such that they would not be picked up in the economy-wide inflation factor, to avoid double counting. The financial effects of an exogenous change should be verifiable and quantifiable, to insure that the effect of an exogenous event can be accurately determined without protracted, controversial regulatory involvement. Positive or negative exogenous changes of less than $3 million will not be considered for exogenous treatment . . .." 1994 Order at p.62.

Although in practice the Commission has approved only one exogenous change, as a general matter the exogenous change factor has operated as the Commission expected. (Am. Ill. Ex. 1.1, pp. 34-36).

However, on a going-forward basis, the Company is requesting that the Commission expressly recognize that exogenous treatment of Commission-mandated rate reductions is appropriate under the Plan. In addition, exogenous treatment for such rate reductions should be allowed to take place immediately, without waiting for the next annual filing under the Plan. (Am. Ill. Ex. 1.1, pp. 36-37; Am. Ill. Ex. 3.0, pp. 10-11). Dr. Staranczak agreed that exogenous treatment is required in such circumstances to maintain the integrity of the X factor, and as a matter of fairness to the Company. (Staff Ex. 2.0, pp. 12-13; Tr. 1259-60, 1262, 1265-66, 1276-77).

2. Pricing Flexibility

One of the purposes of price regulation is to provide the regulated company an opportunity to adjust prices in ways that are consistent with consumer preferences and more appropriate in an increasingly competitive marketplace. Ideally, a price regulation plan allows the company to make gradual changes in its rate structure to eliminate subsidies, to become more market-oriented and to experiment with new offerings. (Am. Ill. Ex. 1.1, p. 42; Am. Ill. Ex. 4.0, pp. 9-10). In its 1994 Order, however, the Commission placed severe restrictions on the Company's pricing flexibility. Upward pricing flexibility was limited to 2% over the percent change in the PCI (which has always been negative) and a rate cap was imposed on basic residential services for five years. 1994 Order at pp. 64-65, 70.[9] As a result, the Company has not been able to increase a single noncompetitive rate since 1994. (Am. Ill. Ex. 1.1, pp. 43-45).

It is critically important that the pricing flexibility component of the Plan be relaxed on a going-forward basis. (Am. Ill. Ex. 1.1, pp. 45-48; Am. Ill. Ex. 3.0, pp. 17-19). As will be discussed in more detail in the rate rebalancing section of this Initial Brief, residence network access lines are priced too low, with substantial support coming from virtually all of the Company's other major service categories and customer groups. To provide a smoother transition to competition and a more efficient rate structure, Ameritech Illinois is proposing that the rate cap not be extended, and that reasonable per-service rate increases be allowed. If the Commission approves the Company's rate rebalancing proposal, Ameritech Illinois is requesting authority to increase individual rates by 5% annually over existing levels; other rates, of course, would have to be decreased to maintain compliance with the PCI. In the event that no rate rebalancing occurs, the limit should be established at 10% annually, subject to a 30% cap on increases in any individual service over the next five years. (Am. Ill. Ex. 3.1, pp. 11-12).

Neither GCI nor Staff have approached this issue in any principled way. Both Ms. TerKeurst and Mr. Koch argued that additional pricing flexibility could "harm ratepayers"

---

[9] The Company took full advantage of the downward pricing flexibility provided by the Plan. During the 1994-99 period, the Company filed 198 noncompetitive service price promotions, which included waivers of nonrecurring charges, waivers of monthly recurring charges, reduced charges for term commitments and cash or bill credits. (Am. Ill. Ex. 1.1, p. 43).

merely because it could result in rate increases for some noncompetitive services. (GCI Ex. 1.0, pp. 42-45; GCI Ex. 11.0, pp. 45-47; Staff Ex. 13.0, pp. 35-36; Staff Ex. 27.0, pp. 20-21). However, harm to ratepayers cannot be defined solely in terms of price increases. As this Commission recognized in numerous rate proceedings during the 1980's, ratepayers are better off if Ameritech Illinois' residence rates cover their costs and are sustainable in a competitive marketplace, even if that means increases in network access line prices. (Am. Ill. Ex. 1.2, pp. 3-4). Customers also benefit, moreover, if the Company can increase these rates gradually, over time, within the confines of the price index, rather than being restricted to major rate rebalancing proceedings with sudden "step" increases resulting from highly litigated proceedings. (Am. Ill. Ex. 3.3, pp. 2-3).[10]

Whatever conclusion the Commission reaches on pricing flexibility within the index, however, no party is proposing that the Company be precluded from filing rate rebalancing proposals during the next term of the Plan, as long as they are subject to conventional tariff and hearing procedures. (Tr. 608-611, 2153-54). Since neither the Commission nor anyone else knows what changes the industry will experience over the next five years, the Commission should not tie its hands in advance. To avoid unnecessary future debates, the Commission should make clear that its decision here is not intended to close the door on future rate design proceedings.

---

[10] Although Mr. Koch opposed additional pricing flexibility, he did <u>not</u> support a renewed cap on basic residence rates. (Tr. 611). Ms. TerKeurst recommended that the cap be reimposed. However, she agreed in cross-examination that her position was premised on the assumption that residence network access line rates were above cost and generating adequate contribution, and that inappropriate rate/cost relationships should not be perpetuated. (Tr. 2152-53.)

3. The Construction of the Baskets

In the 1994 Order, the Commission established four separate baskets for Ameritech Illinois' noncompetitive services: Residence (access lines and usage only), Business, Carrier and Other (discretionary residence vertical features, residence nonrecurring charges, new residence services and other miscellaneous products and services). These baskets were structured to ensure that all customer classes benefited from price regulation; and, with respect to the splitting of residence services between the Residence and Other baskets, to facilitate the application of the price cap on basic network access lines and usage. 1994 Order at p. 68-69.

On a going-forward basis, the Company is proposing that all services which remain under the Plan be consolidated into a single basket. As a result of service reclassifications and the increased number of carrier services which are now priced strictly based on incremental cost standards, there is virtually nothing left in either the Business or Carrier baskets to which the price index can or should apply. This restructure will also provide rate design benefits: it will allow greater flexibility in structuring discounted service packages for customers; and it will permit a meaningful opportunity to restructure rates across customer classes. (Am. Ill. Ex. 3.0, p. 16; Am. Ill. Ex. 4.0, p. 51). Staff's and GCI's concerns that basket consolidation could result in discrimination are misplaced. Reducing the support provided by other customer groups to residential network access line rates will reduce discrimination which exists today, not introduce it. (Am. Ill. Ex. 3.1, p. 12).[11]

[11] Dr. Selwyn raised various scenarios in which Ameritech Illinois could abuse the flexibility offered by a single basket. (Chicago Ex. 1.0, pp. 69-71). Most of his concerns are entirely hypothetical; many of the same scenarios exist under the existing Plan and have never been an issue. (Am. Ill. Ex. 3.1, pp. 13-15).

Even if the Commission rejects this proposal, at a minimum all residence services should be returned to the Residence basket. This modest change would at least give the Company more flexibility to rebalance rates within the universe of residence services in an economically rational manner. There is little disagreement among the parties that, over the long-run, the marketplace will likely drive the prices for residence vertical features and usage down, as residence network access line prices increase, consistent with their underlying economic cost structure. (Am. Ill. Ex. 1.3, p. 129; Chicago Ex. 1.0, pp. 83-85). Changes in nonrecurring and recurring rates for basic residence service can have offsetting impacts on universal service and these interrelationships can be better managed within a single basket. (Am. Ill. Ex. 9.0, p. 9; Tr. 2162). Finally, the small number of services currently assigned to the Residence basket -- the most significant of which are network access lines, which are priced too low today -- will make future annual price cap reductions increasingly problematical. (Am. Ill. Ex. 3.3, p. 4).[12]

A related issue involves the treatment of new services. Under the terms of the current Plan, new services are excluded from the Plan for one year to allow pricing experimentation, and to develop demand levels necessary to adjust the API. After that first year, new residence services are included in the "Other" basket. Staff contends that Ameritech Illinois misused this provision of the Plan by treating calling plans like CallPaks and SimpliFive as new services, because usage services already exist. (Staff Ex. 13.0, pp. 15-16, 24-26).

Staff is incorrect. Calling plans are, by definition, optional and they offer customers choices they did not have before. They are, therefore, properly considered new services. The Company's approach is consistent with the FCC's definition of new services in the federal price

---

[12] The only services in the Residence basket today are network access lines, Band A usage and Band B usage. As discussed in more detail infra, Band A usage rate decreases also present problems. There is a limit on the extent to which usage can bear the entire responsibility for rate reductions.

cap plan, i.e., "a tariff filing that provides for a class or subclass of service not previously offered by the carrier involved and that enlarges the range of service options available to ratepayers". Treating calling plans in this manner is necessary from an administrative perspective, because the historical demand information required to calculate the API does not yet exist. (Am. Ill. Ex. 1.3, pp. 90-92; Am. Ill. Ex. 1.4, pp. 76-78). Furthermore, the Company's approach is consistent with the Commission's objective in establishing the "Other" basket, which was to partition "discretionary" residential services from "basic" residential services. Optional calling plans are clearly discretionary; customers will not purchase a calling plan unless it is economically beneficial to them. (Am. Ill. Ex. 1.3, p. 92). The Company notes, moreover, that this issue would addressed by at least consolidating all residence services in one basket, as the Company proposes.

4. Exclusion of Certain Services

In its 1994 Order, the Commission excluded 911 services from the operation of the index.[13] Subsequently, in Dockets 96-0486/0569 (the TELRIC Order), the Commission excluded UNEs from the Plan, because TA96 requires that UNE prices be set at TELRIC, plus an appropriate allocation of common overhead costs. Order in Dockets 96-0486/0569, adopted February 17, 1998, at p. 85. Staff agrees that the UNE exclusion should be maintained and has not opposed continued exclusion of 911 services. (Staff Ex. 27.0, p. 6).

Ameritech Illinois is recommending that wholesale (resale) services and carrier access charges also be excluded from the operation of the index. Like UNEs, wholesale services are

[13] 911 Services were excluded from the Plan because price increases and decreases are problematical for 911 services: (1) communities fund their emergency response systems through bill charges that are difficult to change quickly; and (2) because the Commission historically established prices for E911 services that were essentially at cost, because of their importance from a public safety perspective. (Am. Ill. Ex. 1.3, pp. 88-89).

priced based on a cost standard established in TA96 (i.e., "avoided costs") and implemented by the Commission in Dockets 95-0458/0531. Order in Dockets 95-0458/0531, adopted June 26, 1996. Ameritech Illinois is entitled to set its wholesale rates based on this standard and nothing in TA96 contemplates further reductions. Separate application of the price index is unnecessary in any event, because wholesale rates must decline with their retail counterparts. (Am. Ill. Ex. 1.3, p. 87). Staff did not provide any reasoned basis on which to differentiate UNEs and wholesale services.

In Dockets 97-0601/0602, the Commission required switched carrier access rates be set at LRSIC, plus a 28.86% common overhead allocation. Order in Dockets 97-0601/0602, adopted March 29, 2000, at pp. 48-49. Further downwards adjustments based on the price index would result in carrier access rates which are below the level which the Commission found to be reasonable and equitable. (Am. Ill. Ex. 3.0, p. 15; Am. Ill. Ex. 1.3, p. 85; Am. Ill. Ex. 1.4, pp. 71-72). GCI and Staff contend that the Order in Dockets 97-0601/0602 should be viewed as setting a price cap, not a price floor, on access charges. (GCI Ex. 3.0, pp. 50-52; Staff Ex. 27.0, pp. 4-6). The Company agrees that changes in both LRSIC costs and the common overhead allocation to carrier access charges could decline over time; however, consistent with the pricing methodology adopted in Dockets 97-0601/0602, such changes should be reflected in up-dated cost studies, a proposition which Staff generally supports. (Staff Ex. 33.0, pp. 3-4; Tr. 591).

Contrary to the contentions of Ms. TerKeurst and Dr. Selwyn, the cost changes reflected in the X factor do not translate into changes in LRSIC/TELRIC costs or common costs. (Chicago Ex. 1.0, pp. 68-69; GCI Ex. 1.0, pp. 51-52). The X factor measures changes in actual operating costs (i.e., "revenue requirement" or accounting-type costs), as productivity gains are achieved in Ameritech Illinois' business, by gradually deploying newer technologies and better operating practices. In contrast, service cost studies ("LRSIC" or "TELRIC") assume that all services are already provided exclusively using forward-looking technologies and forward-looking operating practices. Thus, application of the X factor to carrier access charges (or UNEs) would improperly double-count productivity gains. (Am. Ill. Ex. 1.3, pp. 85-86; Am. Ill. Ex. 1.4, pp. 70-72).

5. Monitoring and Reporting Requirements

Extensive annual monitoring and reporting requirements were imposed by the 1994 Order, as shown in Appendix B to this Initial Brief. 1994 Order at pp. 92-94 and Appendix A, pp. 9-10. The Commission has now had six years experience with the Plan. These existing requirements can be streamlined on a going-forward basis to reduce the costs of regulation, without any loss in appropriate oversight capabilities.

First, the Company has been required to submit an annual infrastructure investment report (Item (7) in Appendix B). This report has since been superceded by the annual investment report required by the SBC/Ameritech Merger Order. Order in Docket 98-0555 ("Merger Order"), adopted September 23, 1999, at p. 19. The same report required by the Merger Order should be used to satisfy any investment reporting requirement associated with the Plan. (Am. Ill. Ex. 1.0, p. 8; Am. Ill. Ex. 3.1, pp. 21-22). No party has objected to this proposal.

Second, Ameritech Illinois submits an annual report on March 31 of each year which details the Company's financial performance over the preceding calendar year (Items (1) - (6) in Appendix B). Ameritech Illinois objected to these earnings-related reporting requirements in Dockets 92-0448/93-0239 on the grounds that they were not appropriate in a price regulation plan. 1994 Order at p. 92. The Company's position has not changed based on experience. Moreover, the stated rationale in 1994 was that high earnings could provide an "early warning" that the productivity offset may have been misspecified. In practice, however, no such use was made of these reports: the productivity offset was not misspecified and there is no reason to believe that it will be misspecified going forward.[14] Therefore, Ameritech Illinois recommends that they be eliminated. (Am. Ill. Ex. 1.0, pp. 10-11). Staff has provided no compelling rationale for their continuation.

Third, as part of that annual report, the Company must also provide summary information relative to the inflation factor, exogenous changes, the service quality component, new services introduced, price changes during the year, and growth by revenue baskets (Items (8) - (11) and (13) - (14) in Appendix B). These requirements should be eliminated because they duplicate more detailed filing requirements which are part of the annual price cap filing required by the Plan. (Am. Ill. Ex. 1.0, p. 12). No party has objected to this proposal.

Finally, the 1994 Order requires an annual demonstration that Ameritech Illinois has been in compliance with Section 13-507 of the Act and the Aggregate Revenue Test during the preceding year (Item (12) in Appendix B). Ameritech Illinois has no objection to continuation of this reporting requirement, if the Commission has found it useful. (Am. Ill. Ex. 1.0, pp. 12-13).

Contrary to the position of GCI, Ameritech Illinois is not proposing that the Commission establish another predetermined, formal review proceeding in its Order in this proceeding. (GCI Ex. 1.0, p. 85-86; Chicago Ex. 1.0, pp. 72-73). The Commission provided for this current review in large part because it had had no prior experience with price regulation prior to 1994; and, even on a national level, pure price regulation plans (i.e., plans without earnings sharing) were

---

[14] This proceeding has also made apparent that the kind of total intrastate earnings information required by the 1994 Order is useless in evaluating how the Plan is functioning, once a substantial number of services have been classified as competitive. If the Commission decides that earnings reports will be required, they should be limited to earnings on the Company's noncompetitive services.

relatively new. Price regulation is now the rule, rather than the exception, and this proceeding provides ample opportunity to fine-tune any components of the Plan which did not meet the Commission's expectations. Under these circumstances, scheduling another formal review is unnecessary. (Am. Ill. Ex. 3.0, pp. 26-27).

In addition, given the time and resources which this proceeding has consumed, there should only be a second review proceeding if it actually proves to be necessary. Section 13-506.1(e) provides the Commission and all parties ample authority to initiate an investigation if the Plan appears to go off track or if there are unexpected marketplace or economic developments. However, to facilitate the Commission's future monitoring of the two key financial components of the index (i.e., GDPPI and the X factor), the Company would not object to providing updated information and/or studies relative to these factors in 2007, at the time the Company submits its annual price cap filing for 2006. (Am. Ill. Ex. 3.3, p. 7).[15]

B. NEW COMPONENTS OF THE PLAN

Ameritech Illinois is not recommending the addition of new components to the Plan. However, in the SBC/Ameritech Merger Order, the Commission anticipated that an "updated price cap formula" could be developed in this proceeding that would permanently flow through the required 50% of net merger savings to customers. Merger Order at p. 149. This expectation has proved to be unrealistic. The Merger Order requires that permanent rate adjustments be based on actual (not estimated) net merger savings; Ameritech Illinois will not reach a "going level" of merger savings until the first quarter of 2003, well beyond the expected final order in

[15] Ms. TerKeurst's proposal that the Company be required to make a filing in 2003, with a final Commission decision in 2004, is particularly dysfunctional. Less than two years would have passed since the Commission's Order in this proceeding. (Am. Ill. Ex. 3.1, pp. 22-23).

this proceeding. Thus, at most, the Commission could determine a methodology now -- not permanent rate changes. (Am. Ill. Ex. 3.0, pp. 28-30).

Both Ameritech Illinois and Staff presented long-term options that would be available to the Commission. (Am. Ill. Ex. 3.0, pp. 30-35; Staff Ex. 4.0, pp. 8-10; Staff Ex. 18.0, pp. 8-12). However, at this juncture, there does not appear to be any consensus as to an appropriate solution. (Am. Ill. Ex. 3.3, pp. 7-10). Therefore, the Company recommends that net merger savings continue to be handled in the annual price cap filings on an interim basis and that the permanent solution be deferred to another proceeding.

Although technically not a "component" of the Plan, GCI recommends that the Commission address what GCI perceives to be "premature" competitive service classifications in this proceeding by establishing new and draconian penalties. (GCI Ex. 1.0, pp. 31-33). Specifically, GCI proposes that Ameritech Illinois be assessed $10,000 per day for any competitive service classification which the Commission ultimately concludes was inappropriate after a contested hearing. Staff has endorsed this proposal as well. (Staff Ex. 27.0, pp. 2-4).

Reclassification penalties are completely unreasonable as a matter of regulatory policy. The Company recognizes that there has been an ongoing disagreement between itself, the Commission Staff and GCI as to how much competition is required to support a reclassification under Section 13-502(b). The Commission will likely provide substantial guidance on this issue in its Order in the pending business service reclassification case (Docket 98-0860). A separate proceeding (Docket 98-0861) has been initiated to establish rules for such classifications. Thus, the fact that the parties are currently at odds and the fact that Docket 98-0860 has proved to be lengthy and complex are not grounds for punishing the Company, as GCI and Staff propose. As Dr. Staranczak testified:

> "The Company did not act illegally by having the services declared competitive. Moreover, the criteria for classifying services as competitive were not established by AI but by the legislature." (Staff Ex. 2.0, p. 5).

There is absolutely no evidence in the record that Ameritech Illinois has acted in bad faith. In fact, more competitive classifications have been approved than rejected by the Commission over the last several years. (Am. Ill. Ex. 1.3, pp. 29-30; Am. Ill. Ex. 1.4, pp. 42-43.)

Nothing in the Public Utilities Act permits the Commission to impose penalties in this situation. This Commission's powers and authority are defined by the terms of the Public Utilities Act. Business and Professional People for the Public Interest v. Commerce Comm'n, 136 Ill. 2d 192, 201, 240 (1989). The Commission's authority to impose penalties is limited by Sections 5-202 and 13-516. These sanctions apply to conduct which violates specific provisions of the Act or specific orders or rules of the Commission. Nothing in either of those Sections would permit the imposition of penalties just because the Commission disagrees with a service reclassification on its merits. In addition, the law disfavors penalties in the absence of demonstrable bad faith, intentional wrongdoing or other comparable conduct, as being violative of due process. Southwestern Telegraph and Telephone Co. v. Danaher, 238 U.S. 482, 35 S.Ct. 886, 888 (1915). Furthermore, Section 13-502(e) already provides mechanisms to ensure that the Company does not profit from, and customers are not harmed by, classifications that are later overturned: the Commission has the authority to require that rates be returned to their reclassification level and that any rate increases be refunded to customers. (Am. Ill. Ex. 1.4, p. 43).

Finally, GCI's reclassification penalty proposal is outside the scope of this proceeding, which was initiated to review the functioning of the Plan under Section 13-506.1. Section 13-506.1 has nothing whatsoever to do with competitive service reclassifications, which are governed by Section 13-502. Even if Ameritech Illinois has reclassified services inappropriately -- which it has not -- that is an issue for another day and another docket.

C. Reinitialization of Rates

The most highly contested issue in this proceeding is whether Ameritech Illinois' rates should be "reinitialized" -- i.e., reduced to the level that would result from a traditional rate case, using rate of return principles. Both Ameritech Illinois and Staff agree that the Company's rates should not be reinitialized. Such an action would be contrary to the principles of price regulation and would devastate the incentive structure which produces so many of the benefits which result from price regulation. Moreover, the magnitude of the rate reductions proposed by GCI would fatally compromise the future of local competition in this state and would effectively bankrupt Ameritech Illinois.

First, reinitialization of Ameritech Illinois' prices is antithetical to the principles of price regulation. The only justification advanced by GCI in support of its rate proposal is that Ameritech Illinois earned more than rate of return regulation would permit and, therefore, that its rates are not "fair, just and reasonable". (GCI Ex. 1.0, pp. 13-16; Chicago Ex. 1.0, pp. 8, 90). This is just rate of return regulation under a different label. As discussed at length in Section II of this Initial Brief, the potential to earn above an authorized return lies at the heart of price regulation's incentive structure and rates are neither unjust nor unreasonable just because the regulated company is successful. As Dr. Staranczak testified:

> "A 'true up' (i.e., resetting rates for Ameritech Illinois that would allow the Company to earn its cost of equity in the test year) would be inconsistent with the principle of alternative regulation which is to focus on prices, not earnings. If under alternative regulation, Ameritech Illinois achieves 'productivity gains' in excess of those proscribed in the price cap formula, then it should be allowed to keep these gains." (Staff Ex. 2.0, p. 4).

Reinitializing rates under these circumstances would signal to Ameritech Illinois -- and other utilities in this state -- that the Commission is not committed to price regulation, which in turn will chill precisely the behavior which the Commission wants to incent. (Am. Ill. Ex. 1.3, pp. 67-68; Am. Ill. Ex. 4.0, pp. 14-15).

Second, rate reinitialization would most particularly blunt Ameritech Illinois' incentives to operate efficiently and invest in new, more risky technologies. (Staff Ex. 2.0, p. 4). To aggressively reduce costs and make large capital investments, the regulated company must believe that it will be allowed to permanently retain the economic benefits of its efforts. Under GCI's approach, the retention period is so short that it offers no improvement over rate of return regulation.[16]

Dr. Selwyn advanced the bizarre argument that reducing Ameritech Illinois rates by $1 billion would "enhance the benefits by incenting the company to redouble its efforts at becoming more efficient". (Chicago Ex. 2.0, pp. 22-23). The world does not work that way. No one -- not individuals and not corporations -- responds positively when the economic fruits of their efforts are unilaterally and arbitrarily withdrawn. (Am. Ill. Ex. 1.4, pp. 58-59).

Third, GCI's proposal is particularly pernicious, because it is so obviously one-sided and opportunistic. Since Ameritech Illinois earned well under the Plan during 1999, GCI seeks to define "just and reasonable" rates solely in the context of rate of return principles. However, if Ameritech Illinois' earnings had been poor, GCI would not be proposing increases in Ameritech Illinois' rates; to the contrary, were Ameritech Illinois to seek rate increases in those circumstances, GCI would undoubtedly be insisting that Ameritech Illinois live with the

[16] Under rate of return regulation, the regulated company retains the benefits of cost-cutting and new investments during the periods between rate cases, which are typically many years apart. Proponents of traditional regulation often argue that this "lag" provides adequate efficiency incentives. The Commission rejected this view in 1994 and it has not improved with age.

regulatory bargain it sought when the Plan was adopted. (Am. Ill. Ex. 1.3, pp. 68-69). GCI has never denied this. Symmetrical treatment of both robust earnings and poor earnings is required as a matter of fundamental fairness to the Company and to preserve the protections which price regulation offers to ratepayers, when and if the Company is impacted negatively by competition and technological change.

Fourth, the Plan's financial performance must be viewed over the long run, not just one year and not even five years. Ameritech Illinois' earnings over the initial period of the Plan were significantly impacted by three factors: (1) the superb economic environment; (2) aggressive cost reductions; and (3) the successful promotion of discretionary services (i.e., vertical features and data services). (Am. Ill. Ex. 8.0, pp. 8-9, 14-18). As Dr. Avera explained, it is unlikely that these conditions are sustainable. With respect to the economy, the last few years have been "as good as it gets". (Am. Ill. Ex. 8.0, p. 13). With the economic growth rate slowing dramatically, Ameritech Illinois' revenues will be impacted generally and discretionary services will be hit the hardest. It will also be difficult to maintain Ameritech Illinois' past record of cost containment: typically, companies make the most obvious cost reductions first and it becomes progressively more difficult to reduce costs further. Growth in discretionary service sales will slow as the market eventually becomes saturated; the growth rates for certain vertical features are already leveling off. (Am. Ill. Ex. 8.0, pp. 19-20, 22-25). Finally, Dr. Avera noted that increasing competition and accelerated technological changes will present a considerable challenge, because of the "size, immobility and embedded technology of [Ameritech Illinois'] network investment". (Am. Ill. Ex. 8.0, p. 25). As Dr. Harris testified, Ameritech Illinois is running a risk just to guarantee productivity performance based on the 1992-98 period, as reflected in the proposed X factor of 3.3%. (Am. Ill. Ex. 4.0, pp. 50-51).

In substance, GCI is proposing that rates be reinitialized based on Ameritech Illinois' financial performance during the single best year of the Plan (1999), which in turn occurred in the single most remarkable economic period which this country has experienced.[17] As the economy returns to normal, or even enters a recession, Ameritech Illinois' business will likely contract. At the same time, competition and technological change will be accelerating. Under these circumstances, GCI's proposal is fundamentally unfair and is a recipe for financial trouble over the long run. The marketplace, not the regulatory process, should be permitted to determine Ameritech Illinois' earnings, as price regulation contemplates.

Fifth, reinitialization of Ameritech Illinois' rates would have a devastating impact on the prospects for local exchange competition in Illinois. Although there is substantial competition for business customers today and it is growing at a rapid rate, competition for residence customers has not yet developed to the same degree. One of the major reasons for this slow growth is that the same public policies which have kept residential rates affordable have also reduced the profit potential for competitors. As FCC Chairman Powell recently remarked at NARUC:

> "'Retail rates are not an irrelevant part of an economic market' and regulators may have to make a choice between 'sustainable businesses' for new market entrants and low prices for end users." TR Daily, February 28, 2001, pp. 2-3 (administrative notice requested).

Although this Commission made more progress than most towards an economically rational local exchange rate structure during the 1980's, that progress stalled in 1989 with Ameritech Illinois' last major rate rebalancing initiative. (Am. Ill. Ex. 1.1, pp. 45-46). The fact that residential competition in Illinois is not yet robust clearly signals that, even at existing profit

[17] Even if earnings are viewed solely in the context of the 1994-99 period, 1999 clearly represented a watershed year. (Am. Ill. Ex. 7.0, Sch. 3).

margins, the CLECs have more attractive business opportunities. (Am. Ill. Ex. 1.3, pp. 69-70; Am. Ill. Ex. 1.4, pp. 60-61). A $1 billion reduction in Ameritech Illinois' local service rates would devastate the economics of this business. Competitors' potential profit margins for a typical residential customer would fall by more than 50%. (Am. Ill. Ex. 1.3, pp. 71-73; Am. Ill. Ex. 1.4, pp. 65-66, Sch. 1). In view of the CLECs' already tepid response to the residential exchange business, the new "improved" rates proposed by GCI will absolutely fail in the marketplace. [18]

Determined to ignore the economic consequences of GCI's proposal, Ms. TerKeurst cavalierly suggested that any lack of competition in the future simply means that the local marketplace is a "natural monopoly". (GCI Ex. 11.0, p. 23). If that were true, then this entire nation has been on a fool's errand for almost a decade. The Company acknowledges that there is still uncertainty about precisely how and when competition for residence customers will take hold in the marketplace; the evidence to date suggests that long distance entry by the incumbent carrier has a galvanizing impact on CLEC marketing activities. (Am. Ill. Ex. 1.4, p. 65). However, the one certainty that would result from adopting GCI's rate proposal is that this Commission will have allowed the regulatory process to squeeze all of the profit potential out of this marketplace and will never know what the real prospects were for local competition. (Am. Ill. Ex. 1.4, pp. 64-65).

Finally, GCI's proposal would have a devastating financial impact on Ameritech Illinois. The proposed $1 billion rate reduction represents over 30 percent of the Company's intrastate revenues. It would reduce the Company's balance available for return by about $650 million.

[18] Although Staff is not proposing reinitialization of Ameritech Illinois' rates, Staff's "preferred" approach in the event that Commission disagrees would leave CLECs with negative margins and no realistic way to compete. (Am. Ill. Ex. 1.3, pp. 73-74).

Since Ameritech Illinois' balance available for return is $590 million, this means that it would have negative earnings.[19] The Company would be unable to meet its intrastate debt obligations and debt ratings would fall precipitously. The Company would be unable to invest in new plant, much less modernize its network and improve service quality. If there is no money to spend, Ameritech Illinois will be able to spend nothing -- no matter what regulatory obligations may be imposed on it. Capital only flows to those enterprises where investors (whether internal or external) believe they can earn a fair return. As Dr. Avera testified, investors have already discounted Ameritech Illinois' past financial performance based on assessments of its sustainability and massive rate reductions would be perceived very negatively by the investment community. (Am. Ill. Ex. 8.0, pp. 26-27). It would serve no one's long-term interests -- not customers, not competitors who depend on Ameritech Illinois' network to serve their own customers and not economic development in the State -- to financially cripple Ameritech Illinois. (Am. Ill. Ex. 1.3, pp. 74-75).

D. EARNINGS SHARING

Notwithstanding the fact that the Commission thoroughly considered earnings sharing in 1994 and rejected it, GCI claims once again that it is an essential and necessary addition to this Plan. In fact, Ms. TerKeurst recycled precisely the same proposal which she advanced in 1994 when she was a member of the Commission Staff. Both Ameritech Illinois and Staff categorically oppose earnings sharing.

The fundamental problem with earnings sharing is that it is rate of return regulation. It brings with it all of the baggage of rate of return regulation: debate over depreciation rates;

---

19 These numbers were updated from Am. Ill. Ex. 1.3, p. 75, based on Mr. Dominak's final schedules (Am. Ill. Ex. 7.3, Sch. 1 and 2).

extensive reporting and monitoring of Illinois Bell's investments, rate base and profitability; prudence reviews; and, no doubt, continuing debates over the level of profits Illinois Bell is earning and how much it should be allowed to keep. In effect, the issues which have occupied the revenue requirements side of this review proceeding will continue ad infinitum, with opportunities for parties to revisit them in each annual price cap filing. (Am. Ill. Ex. 1.3, p. 54; Am. Ill. Ex. 4.2, pp. 12-13; Staff Ex. 16.0, pp. 1-3). Thus, earnings sharing does not break the link between Ameritech Illinois' cost and rates, the critical component in price regulation, and will result in higher, not lower, regulatory costs and delay.

Earnings sharing plans blunt the efficiency incentives of price regulation. Once the 50% sharing threshold has been reached, earnings incentives are reduced dramatically and they are eliminated altogether once the cap is reached. (Am. Ill. Ex. 1.3, pp. 56-57; Staff Ex. 16.0, p. 3). Moreover, because GCI's accounting adjustments flow through in rate reductions the equivalent of 1,311 basis points in earned return, the Company would be required to share before its actual earnings ever reached a reasonable level. (Am. Ill. Ex. 1.3, pp. 56-57). Thus, many of the most important behavioral benefits of price regulation will be lost, as the Commission recognized in 1994.

Earnings sharing is fundamentally inconsistent with the Commission's decision in 1994 to allow Ameritech Illinois to assume responsibility for capital recovery. The endless debate over depreciation in this proceeding clearly demonstrates why depreciation freedom and earnings regulation are incompatible. Ms. TerKeurst agreed on cross-examination that whatever decision the Commission makes on depreciation issues in this case would be frozen for the next five years to calculate sharable earnings, absent another Commission proceeding. (Tr. 2166). Thus, if the Commission adopts GCI's earnings sharing proposal, it will be back in the business of prescribing Ameritech Illinois' depreciation rates. However, the Commission is no better able to fulfill its side of the regulatory bargain now -- i.e., to ensure full capital recovery of long-lived plant through prices over the next 20-30 years -- than it was in 1994. This is the policy dilemma which the Commission found unacceptable then and GCI proposes no solution. (Am. Ill. Ex. 1.3, pp. 55-56).

Contrary to GCI's view, earnings sharing is neither useful nor appropriate as a "safety net" in the event the index is misspecified or as a means of controlling for the impact of economic conditions. (GCI Ex. 1.0, pp. 67-68). As noted above, it is an entirely different regulatory model which brings with it a host of problems which compromise the very objectives of price regulation. Moreover, the Commission has now had five years of experience with the key financial components of the index. The index was not misspecified in 1994 and there is no reason to believe it will be misspecified here. The impact of economic conditions is something that the Commission should not attempt to control. If the economy is healthy and there is strong demand for Ameritech Illinois' services, the Company will benefit. If the economy weakens and demand for Ameritech Illinois' services falls off, the Company will suffer. As long as the relationship is symmetrical, it is appropriate and there is no problem which needs to be "fixed". (Am. Ill. Ex. 1.3, p. 58).

Finally, GCI's proposal that earnings sharing apply to both competitive and noncompetitive services is legally improper. As noted previously, Section 13-506.1, by its terms, is limited to noncompetitive services. Therefore, only earnings on noncompetitive services can be shared. In order to calculate earnings on noncompetitive services, the Commission would have to accept a cost allocation methodology comparable to what the Company presented. Furthermore, noncompetitive services today are earning well below any reasonable view of

Ameritech Illinois's cost of capital; it is almost inconceivable that these earnings could increase to a level where GCI's earnings sharing benchmark would ever be triggered. Under these circumstances, the administrative costs associated with monitoring earnings and performing the requisite allocations between competitive and noncompetitive services cannot be justified. (Am. Ill. Ex. 1.3, pp. 61-62).

Fundamentally, the time for earnings sharing had already come and gone by 1994.[20] Many regulators in the late 1980's and early 1990's viewed earnings sharing as a comfortable transitional mechanism between rate of return regulation and price regulation when price regulation was new and was perceived to be risky. However, that period has long since passed. Even regulators who adopted earnings sharing early on -- e.g., the California PUC and the FCC, on whose plans Ms. TerKeurst modeled her proposal -- have moved on to pure price regulation. (Tr. 2163-2165). Ms. TerKeurst's views on regulation fossilized in the late 1980's and provide no useful guidance in 2001.

E. Rate of Return Regulation

As an alternative, the City of Chicago and GCI suggest that the Commission could revert to rate of return regulation. Rate of return regulation is hopelessly outdated and is not a viable regulatory alternative in 2001. Appropriately, neither Ms. TerKeurst nor Dr. Selwyn devote more than a couple of sentences to this proposal. (See e.g., GCI Ex. 1.0, p. 9; Chicago Ex. 1.0, pp. 6-7, 53-54). The Commission fully evaluated the relative benefits of rate of return regulation and price regulation in 1994. It concluded then that rate of return regulation did not respond to the dramatic changes taking place in the telecommunications industry, would not appropriately

[20] This Commission adopted an earnings sharing plan in 1989 in Docket 89-0033, which was later reversed on appeal as being beyond the Commission's authority. Section 13-506.1 was enacted in response to that decision.

protect customers of noncompetitive services and would not provide Ameritech Illinois with the freedoms necessary to prepare for a more competitive marketplace. The intervening five years have made the need for price regulation more urgent -- not less.

IV. SERVICE QUALITY - GOING FORWARD

A. THE ACT REQUIRES THAT AN ALTERNATIVE REGULATION PLAN MAINTAIN, NOT IMPROVE, SERVICE QUALITY

The Act provides that an alternative regulation plan should be approved if it "will maintain the quality" of telecommunications services. 220 ILCS 5/13-506.1(b)(6). In ordinary English, "maintain" means "to keep in an existing state." (Am. Ill. Ex. 3.1 at pp. 2-3 quoting Webster's Ninth New Collegiate Dictionary 718 (1989)). In the 1994 Order, the Commission ruled that "maintain" does not mean "improve," and that it may not review an alternative regulation plan with the goal of improving, rather than simply maintaining, service quality. 1994 Order at p. 58.

In Docket 92-0448, Ameritech Illinois proposed that the price index calculation should be adjusted upward if Ameritech Illinois exceeded benchmark performance levels, instead of providing for a downward adjustment only. Staff and intervenors opposed that idea, arguing that the Act permitted the Commission to review the proposed plan based only on whether the plan would maintain service quality at an appropriate "going in" level, not whether the plan would improve service quality. Both Dr. Selwyn (then testifying on behalf of the Attorney General) and Ms. TerKeurst (then testifying on behalf of Staff) took that position. 1994 Order at pp. 56-57; see Am. Ill. Ex. TerKeurst Cross 45. The Commission adopted the Staff and intervenor position, finding as follows:

> Section 5/13-506.1(b)(6) requires the Commission to find that an alternative regulation plan will **maintain** the quality and availability of telecommunications services (emphasis

> added [by the Commission]). The Commission believes that the best way to eliminate the Company's incentive to reduce service quality will be to adopt a service quality component which penalizes the Company for not maintaining service quality but does not provide additional reward for exceeding current performance. 1994 Order at p. 58 (emphasis by the Commission).

Both Staff and GCI continued to take that position in this proceeding, at least until Ameritech Illinois pointed out that their position was inconsistent with certain aspects of their proposals—which to varying degrees would require service quality improvements over both historical performance and the standards in the Commission's rules. For example, Dr. Selwyn testified, "The Commission did not implement the service quality component in an effort to improve Ameritech Illinois' quality, only to maintain it." (Chicago Ex. 1.0, pp. 66-67 (emphasis by Dr. Selwyn)). Staff witnesses Hoagg and McClerren testified similarly. (See, e.g., Staff Ex. 1.0, p. 21; Staff Ex. 8.0, p. 5).

In its rebuttal testimony, Ameritech Illinois pointed out that various aspects of Staff's and GCI's service quality proposals would require it to improve, not simply maintain, service quality. (Am. Ill. Ex. 3.1, pp. 5-6; 8-9; Am. Ill. Ex. 12.0, pp. 28-29, 39). At that point, Staff witness Hoagg and GCI witnesses Selwyn and TerKeurst changed their positions, arguing that the Commission may, in approving an alternative regulation plan, require that Ameritech Illinois not only maintain, but improve, service quality. They argued that circumstances have changed since 1994, and that the Commission need not follow the 1994 Order. (Staff Ex. 15, pp 1-4; GCI Ex. 12.0, pp. 21-23; Chicago Ex. 2.0, p. 26). Their argument should be rejected for at least two reasons (in addition to the obvious inconsistencies in the Staff and GCI testimony).

First, the Commission's conclusion in the 1994 Order was not a finding of fact; it was the Commission's interpretation of the language of the Act. Even if the facts might have changed, the Act itself has not. "Maintain" cannot mean one thing in 1994 and the opposite in 2001. (Am. Ill. Ex. 3.4, p. 2).

Second, the facts have <u>not</u> changed in any fundamental way. In 1994, as here, both the Commission and the parties were well aware that Ameritech Illinois has not always met the Commission's standard for OOS>24. To address that fact, the Commission based its benchmark on the standard in the Commission's Part 730 rules. However, the Commission did not otherwise require improvements to existing service quality levels. (Am. Ill. Ex. 1.3, pp. 13-14; Am. Ill. Ex. 3.1, pp. 5-6). Ameritech Illinois has taken the same approach here. It has proposed benchmarks and penalties designed to maintain existing performance levels where performance is consistent with the Part 730 standards. Where performance falls short of the Part 730 levels or where inadequate historical data are available, Ameritech Illinois has proposed the Part 730 standard as the benchmark. (Am. Ill. Ex. 1.4, pp. 16-19). At Staff's suggestion, Ameritech Illinois has also eliminated 2000 data from its proposed benchmark calculations. (Am. Ill. Ex. 12.1, p. 21; Am. Ill. Ex. 3.4, pp. 15-16). That approach is consistent with the 1994 Order and is sufficient to assure that the proposed benchmarks reflect appropriate levels of service quality. (Am. Ill. Ex. 3.4, pp. 2-3).

In short, the Commission should, consistent with the 1994 Order, conclude that the Act requires an alternative regulation plan to maintain, not improve, service quality. All benchmarks and penalties should be consistent with that goal.

B. <u>THE COMMISSION SHOULD ADOPT THE SERVICE QUALITY MEASURES PROPOSED BY STAFF, SUBJECT TO AMERITECH ILLINOIS' PROPOSED DEFINITIONS AND BENCHMARKS.</u>

The Commission included eight measures of service quality when it adopted the existing Plan. The Commission based the associated benchmarks on actual, historical performance levels, with one exception. For Out of Service Over 24 Hours ("OOS>24"), because Ameritech Illinois' historical performance generally fell short of the standard in the Commission's Part 730 rules (83 Ill. Admin. Code Part 730), the Commission adopted the benchmark in those rules. The Commission found that approach to be consistent with the statutory goal of maintaining service quality. 1994 Order at p. 58. Of the three proposed sets of measures and benchmarks now before the Commission, Ameritech Illinois' is entirely consistent with the 1994 Order and the Act, Staff's is mostly consistent with the 1994 Order and the Act (with the primary exception of Staff's proposed benchmarks for business and repair office answer time), and GCI's proposal is entirely inconsistent with the 1994 Order and the Act.

Staff has proposed that the following service quality measures be included in the Alternative Regulation Plan: (1) Installation Within Five Business Days, (2) Trouble Reports per 100 Access Lines, (3) Out of Service Over 24 Hours, (4) Operator Speed of Answer—Toll, Assistance and Information, (5) Repeat Repair Reports, (6) Missed Repair Appointments, (7) Missed Installation Appointments, (8) Speed of Answer—Repair Office, and (9) Speed of Answer—Business Office. (Staff Ex. 23, pp. 28-29). Staff's proposal calls for the elimination of three of the existing measures (Dial Tone Within Three Seconds, Operator Speed of Answer—Intercept and Trunk Groups Below Objective), the retention of three of the existing measures (1-3, above), the combination of two of the existing measures (4, above), and the adoption of five new measures (5-9, above). (Staff Ex. 23, pp. 28-29). The Company generally agrees with Staff's proposed service quality measures, subject to a few issues regarding the definition or calculation of some of the benchmarks. (Am. Ill. Ex. 12.0, pp. 27-31; Am. Ill. Ex. 12.1, pp. 15-16).

Staff and the Company also generally agree that the Commission should follow the same approach to developing benchmarks that it did in the 1994 Order. For most measures, this means that benchmarks will be based on actual, historical performance. (Am. Ill. Ex. 3.2, pp. 3-9; Am. Ill. Ex. 3.4, pp. 14-18; Staff Ex. 23, pp. 21-23). The primary differences between Staff's and Ameritech Illinois' positions on benchmarks are: (1) what historical data to use in calculating the benchmark performance level, and (2) how to determine the benchmarks when only limited historical data are available or when available data fall short of the standards in the Commission's Part 730 rules. (See Am. Ill. Ex. 3.4, pp. 14-17; Am. Ill. Ex. 12.1, pp. 17, 21-22).

By contrast, GCI has proposed twenty service quality measures. (GCI Ex. 12, pp. 18-47 & Ex. 12.5). Moreover, while that number might appear to include many of same the nine measures supported by Staff and Ameritech Illinois, GCI has redefined most of those measures significantly. As a result, only a few of GCI's proposed measures are actually the same as those supported by Staff and Ameritech Illinois. (Am. Ill. Ex. 12.0, pp. 39-48). If adopted, the GCI proposal would increase the number of service quality measures subject to the Alternative Regulation Plan by a factor of two and a half, from eight to twenty.

GCI's proposed new benchmarks are also far more stringent from those in Ameritech Illinois' proposal, in Staff's proposal or in the existing Plan. Unlike the benchmarks the Commission adopted in the 1994 Order, GCI's proposed new benchmarks generally do not take into account actual, historical performance levels. Instead, GCI's new benchmarks are based on grab bag of internal performance targets (frequently redefined and misapplied) and what Ms. TerKeurst cryptically described as "other" factors. (Am. Ill. Ex. 12.0, pp. 39-48; see GCI Ex. 12.5). The record contains no evidence that Ameritech Illinois or any other local exchange carrier has actually performed at levels sufficient to achieve those standards. In fact, Ms. TerKeurst conceded that she could not name a single carrier that has done so. (Tr. 2134).

Appendix C to this Brief shows the service quality measures and benchmarks under the existing Plan compared to those proposed by Ameritech Illinois, Staff and GCI. A benchmark identified by an asterisk indicates that the party proposing that benchmark has redefined the relevant service quality measure in a manner that renders available data inapplicable. For each such benchmark, historical performance levels cannot be determined from available data.

1. Staff's Proposed Measures and Associated Benchmarks.

As noted above, Staff proposes nine service quality measures in place of the existing eight. Of those, three are included in the current Plan, one combines two existing measures and five are new measures. (See Staff Ex. 23, pp. 28-29). Ameritech Illinois has agreed that Staff's proposed service quality measures would reasonably measure service quality. Staff's proposed measures would, if appropriately defined and combined with appropriate benchmarks, satisfy the statutory goal of maintaining service quality. (Am. Ill. Ex. 12.0, pp. 27-31; Am. Ill. Ex. 12.1, pp. 15-16).

Ameritech Illinois proposes to base new benchmarks on actual, historical data for the years 1994-99, whenever such data are available, assuming that performance level does not fall below a standard imposed by Part 730. Using five years of data provides a sufficient database to account for seasonal and year-to-year changes that will affect service quality, resulting in the best available picture of the service quality levels to be maintained under the Plan. (Am. Ill. Ex. 3.4, pp. 17-17; Am. Ill. Ex. 12.1, pp. 21-22). Ameritech Illinois has used 1994-99 data to calculate its proposed benchmarks for Repeat Repair Reports, and Missed Repair Commitments (Field Visit). For Missed Installation Commitments (All Commitments), 1995 data were not available, so Ameritech Illinois has proposed a benchmark using data from 1996-99. (Am. Ill. Ex. 3.4, pp. 15-16 & Sch. 3.42).

Staff also generally relies on historical performance data for calculating its proposed new benchmarks. Staff would use data for 1998-99, with the six highest and lowest data points eliminated. As Ms. Jackson testified, Staff's methodology is based on the one adopted by the Commission in the 1994 Order to calculate the Plan's exiting benchmarks. (Staff Ex. 23, p. 22).

Either Ameritech Illinois' or Staff's position would be reasonable. Using five years of data has essentially the same purpose as eliminating the high and low data points: to moderate the impact of short-term fluctuations of the benchmarks. However, using five years of data , as Ameritech Illinois proposes, will better account for seasonal and year-to-year changes than would using two years of data. (Am. Ill. Ex. 3.4, p. 17).

Three of Staff's proposed new measures reflect new Part 730 measures adopted in Docket 98-0453, effective in October 2000: Average Speed of Answer-Repair, Average Speed of Answer-Customer Calling Centers and Missed Installation Commitments. Because these are new requirements, the limited data available for these measures do not establish a historical level of performance consistent with the new Part 730 rules. As a result, consistent with the 1994 Order's treatment of 00S>24, Ameritech Illinois has proposed benchmarks based on the standards in Part 730.[21]

Staff initially proposed benchmarks for both of these measures that were based on Ameritech Illinois' internal performance targets for business office answering time. (Staff Ex. 9.0, p. 24). However, in its rebuttal testimony, Staff indicated that it would reconsider its

---

[21] For Missed Installation Commitments, the availability of historical data depends on whether vertical service orders are included, as further explained below. Therefore, Ameritech Illinois has proposed alternative benchmarks based on historical performance (for all commitments, including vertical service orders) and on the Commission's Part 730 rules (for "regular service" installations).

position in light of additional historical data, which Ameritech Illinois provided in Mr. O'Brien's supplemental surrebuttal testimony (See Staff Ex. 23, pp. 28-29; Am. Ill. Ex. 3.4, Sch. 3.43). Therefore, Ameritech Illinois will respond specifically to Staff's proposed benchmarks for these measures in its Reply Brief.

With the exception of the issues above, the differences between Ameritech Illinois' and Staff's positions on measures and benchmarks are modest. Those differences are addressed, measure by measure, below.

Installation Within Five Business Days (Current). All parties agree that Installation Within Five Business Days (or seven calendar days) should remain one of the service quality measures under the Alternative Regulation Plan. However, Staff and GCI have argued that this measure should be redefined to exclude orders limited to vertical services. Staff's and GCI's witnesses testified that installation of vertical services is less time-consuming than installation of new or additional access lines. They argued that, because vertical service orders have likely grown over time, the inclusion of such orders in installation data "may mask additional service quality problems." (GCI Ex. 2.0, pp. 29-30; see also Staff Ex. 8.0, pp. 8-10).[22] The Commission should either reject Staff's and GCI's proposal and retain the existing benchmark and measure, or, if the measure is redefined, set the benchmark at 90%, consistent with the standard in the Commission's service quality rules.

As Mr. Hudzik testified, Ameritech Illinois has always reported installation data in the same way it does today. (Am. Ill. Ex. 12.0, pp. 17-20). Thus, the calculation of the existing

[22] Staff witness McClerren initially testified that Ameritech Illinois had actually changed its reporting at some time during the 1990's. (Staff Ex. 9.0, pp. 8-9). However, Mr. Hudzik testified that this is not the case; to the contrary, Ameritech Illinois has always reported installation data in the same way. (Am. Ill. Ex. 12.0, p. 17, Am. Ill. Ex. 12.1, p. 23).

benchmark included vertical service orders. Changing the definition of the benchmark without adjusting the benchmark itself would, in effect, arbitrarily raise the standard of service reflected in the plan. Such an increase would be inconsistent with the Commission's determination (and both Staff's and GCI's positions) in the 1994 Order that the goal of the Act is to maintain, not improve, service quality. (Id.; Am. Ill. Ex. 12.1, pp. 23-24).

Staff and GCI have argued that no adjustment in the benchmark is needed, because vertical service orders would have been negligible at the time the current Plan was adopted. For example, Mr. McClerren testified that vertical services "did not become a product until the early 1990's . . ." (Staff Ex. 8.0, p. 9). Similarly, Ms. TerKeurst described the number of vertical service orders prior to the adoption of the existing Plan as "negligible" and their impact on performance data as "miniscule." (GCI Ex. 12.0, pp. 26-27).

Ms. TerKeurst and Mr. McClerren are clearly incorrect. Vertical services were well established long before the Plan was adopted. In fact, the vast majority of Ameritech Illinois' current vertical services were introduced between 1974 and 1989. (Tr. 1790-96; Am. Ill. McClerren Cross Ex. 34; Am. Ill. McClerren Cross Ex. 35; Am. Ill. McClerren Cross Ex. 36; Am. Ill. McClerren Cross Ex. 37). It is true that vertical services have generally grown in proportion to total installation orders. However, the record does not show how fast they have grown, so it is not possible to conclude that such orders would have been "negligible" prior to the adoption of the current Plan. (Tr. 1816-19). As a result, if the definition proposed by Staff and GCI is adopted, a new benchmark must be set.

The Commission should apply the benchmark in the Part 730 rules (90%), as it did for OOS>24 in the 1994 Order. Only limited data are available for installation orders excluding vertical services. Beginning in July 1999, Ameritech Illinois began to provide Staff with such data. The available data show that Ameritech Illinois would not have consistently achieved the 90% standard imposed by the Part 730 rules, had vertical service orders been excluded, so the proper benchmark is the one in Part 730. (Am. Ill. Ex. 12.1, pp. 23-26).

Trouble Reports per 100 Access Lines (Current). All parties favor retention of the existing measure and benchmark for Trouble Reports per 100 Access Lines.

Out of Service Over 24 Hours ("OOS>24") (Current). All parties favor retention of the measure for OOS>24, along with the existing benchmark of five percent. GCI has questioned whether Ameritech Illinois may have overstated "Act of God" (i.e., weather) exclusions by removing trouble reports attributable to unusually severe weather from the numerator in the OOS>24 calculation, but not the denominator. (GCI Ex. 12.0, pp. 29-30).

Ameritech Illinois' method of calculating weather exclusions is entirely consistent with past practice, and it is entirely appropriate. As Mr. Hudzik testified, Ameritech Illinois has calculated and reported its OOS>24 data consistently since well before the current Plan was adopted. Moreover, the exclusion of weather-related troubles from the denominator in the equation "would artificially reduce the total number of troubles, essentially implying that [the weather-related troubles] did not exist." That would be inappropriate, as the additional troubles caused by weather remain a part of the workload. (Am. Ill. Ex. 12.1, p. 27). As a result, no change in Ameritech Illinois' reporting for OOS>24 is appropriate, and the Commission should approve the current calculation methodology. At a minimum, the Commission should approve the company's current methodology until the completion of the pending Part 730 rulemaking proceeding.

Percent Dial Tone Within Three Seconds (Current). The parties agree that the existing measure for Percent Dial Tone Within Three Seconds should be eliminated from the Alternative Regulation Plan.

Operator Speed of Answer—Intercept (Current). The parties agree that the existing measure for Operator Speed of Answer—Intercept should be eliminated from the Alternative Regulation Plan.

Operator Speed of Answer—Toll, Assistance and Information (Current/Combined). Staff has proposed that the existing measures and benchmarks for Operator Speed of Answer—Toll and Assistance and Operator Speed of Answer—Information be combined. As Ms. Jackson testified, "the existence of two standards for operator services is unduly burdensome." (Staff Ex. 9.0, p. 26). Ameritech Illinois concurs. (Am. Ill. Ex. 12.0, p. 25). GCI opposes Staff's position. Ms. TerKeurst testified that combining the measures "may encourage Ameritech Illinois to increase the time taken to answer toll and assistance calls . . ." (GCI Ex. 12.0, p. 31).

The Commission should adopt Staff's and Ameritech Illinois' position. Retaining separate benchmarks for the operator assistance measures is not warranted, particularly given that Operator Speed of Answer has not been a problem since the adoption of the Plan. (Staff Ex. 9.0, p. 26). Ms. TerKeurst's position is also speculative; there is no evidence that combining the existing measures would result in performance falling below appropriates levels. In fact, Ameritech Illinois has met the benchmarks for both Toll and Assistance and Information calls consistently and by increasing margins over the term of the Plan. (Staff Ex. 8.0, Attach. 8.01). Moreover, any increases in answer times would be reflected in the overall average, so Ameritech Illinois' ability to prioritize one set of calls over the other would be very limited.